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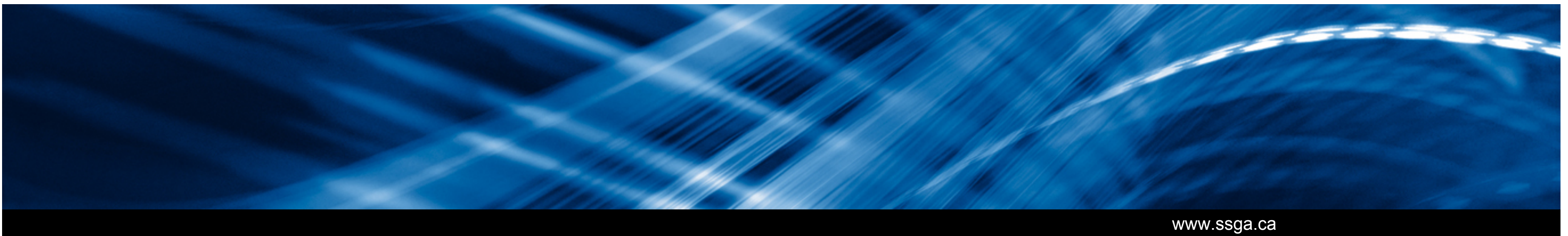

Month End Investment Commentary Report

As of 31 Jul 2012

University of Western Ontario

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Canadian Fixed Income Market Commentary

July 2012

Global Economic Background
Volatility was the primary feature of markets this month. Intensifying stresses in Spain and incoming economic data that remains no better than mixed were responsible for the lack of conviction in improving risk appetites at mid-month. On the other hand, the relative optimism seems to reflect rising expectations of more central bank easing as well as the arguably positive tone to the earnings season so far.

In Spain, the news on the economic, financial and fiscal fronts remain worrisome. First, home prices fell another 2.5% in Q2, their 17th consecutive quarterly decline to 23.0% below the 2008 peak. Second, the banking system remains quite troubled and the runoff of deposits is accelerating. Third, economic and banking worries are still intensifying stresses on the sovereign, reflected this week in a reportedly poor Spanish debt auction and benchmark 10-year yields hitting the troubling 7.00% level once again. Perhaps the only good news for Spain this is that the aid package for Spanish banks was formally approved by Euro Group finance ministers on July 20th.

Meanwhile, the economic data flow at mid-month-in the US specifically-has been no better than mixed. Investors clearly took great comfort from the continued improvement in housing reflected in rising starts and firmer prices. However, the data also showed an unmistakable slip in retail sales during Q2, a sharp slowing of industrial production in the quarter despite a decent June print, and the discouraging rebound in jobless claims. Indeed, on balance, the data flow (including from earlier weeks) suggests that the US economy has fallen into another soft-patch.

On July 26th, perhaps in response to the alarming rise in stress in Spain's markets, European Central Bank (ECB) President Draghi reportedly pledged to do whatever is necessary to protect the euro. Markets rallied, clearly interpreting this as a signal that the ECB is poised to intervene in bond markets to rein in volatility by reviving its dormant Securities Market Program or perhaps launching another stage of Long Term Refinancing Operations (LTROs).

Nonetheless, the equity markets still ended up with timid returns for the month of July. The MSCI World Index was up 1.37% in local terms. While most markets ended the month in positive territory, heavyweights like the United States, the U.K. and Canada delivered unimpressive returns (1.36%, 1.28% and 0.51% respectively). Japan, Spain, Italy and Ireland were the only 4 markets to bring the index down.

Actual and future policy stimulus expectations supported a bid for commodities. The EUR dropped to a two-year low at the end of the month and then rebounded following Draghi's promise to protect the euro.

Canadian Economic Background
Employment rose just 7,300 in June, but the quality of employment improved quite markedly as 22,000 part-time jobs were replaced by 29,300 full-time ones. However the gains were concentrated in the public sector, where payrolls expanded 38,900. Jobs in the private sector actually shrank 26,000. The increase in employment, combined with a 16,800 drop in the labor force reduced unemployment by 24,100, enough to lower the rate a tick to 7.2%, the (joint) lowest so far in this recovery.

The Bank of Canada (BoC) left its policy rate unchanged as expected. The Bank retained the mild tightening bias originally adopted at the April 17 policy meeting, although it also retained the hedge to this bias adopted at the last meeting on June 9. The BoC also released its quarterly Monetary Policy Report this week, in which the Bank modestly downgraded its economic outlook for the next couple of years. Specifically, it now forecasts GDP growth of 2.1% in 2012 (down from 2.4% in the April report) and 2.3% in 2013 (down from 2.4%).

On the inflation front, consumer prices (CPI) fell a seasonally-adjusted 0.2% in June, their second straight decline. As in May, the June decline primarily reflected sharply slower gasoline prices. However, food was also down modestly in June. The CPI inflation rate actually rose three ticks because of base effects, although it still posted at a benign1.5% y/y-still well below the BoC's 2.0% target. Core inflation edged up two ticks to 2.0%.

Retail sales remain stagnant. They did rise 0.3% in May but this modest gain followed a 0.6% fall the previous month. Moreover, sales have been stuck on a plateau for the last several months, and indeed, May's sales level was identical to last November.

Canadian Bond Market
The Canadian bond market, as measured by the DEX Universe Bond Index TM, returned 0.66% in July with all subsectors posting gains for the period. This month's performance brings year-to-date return of the Index to 2.71%. Corporate and Provincial sectors lead the way for the month with total returns of 0.96% and 0.89% respectively while Federals bring up the rear with a return of 0.31%. This strong performance of the corporate sector came as over 4 billion in new corporate issuance and reopening were brought to market during the month, which underlines the demand for new issues in a period where secondary market liquidity remains constrained.

From a curve perspective, the short end of Canadian curve sold off in the later part of the month as some investors interpreted the tone of Bank of Canada's Monetary Policy Report and policy announcement as a sign that the Bank was not willing to cut rates further despite the weakness of the recovery and recent easing by other central banks. In the subsequent flattening of the yield curve, the Short-Term Canada Index gave up most of its month to date gains, ending the month in positive territory by the barest of margins with a return of 0.01%, the weakest performance of all sub-indices.

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Performance shown is gross of fees and expenses.
CanPE-0318

SSgA Enhanced Canadian Universe Bond Fund Investment Commentary

July 2012 performance attribution (bps)

Dura.	Curve	Corp.	Provi. / Agencies	Carry	Others	Month Total
0	+2	+1	+1	0	-2	+2

Past performance is not a guarantee of future results.

The SSgA Enhanced Canadian Universe Bond Fund returned 0.68% for July 2012, outperforming the DEX Universe Bond Index™ by 2 basis points (bps). Overall, our overweight to corporate and provincial credits had a positive impact on performance, adding 2 bps in aggregate to relative returns as both sectors outperformed federal issues. Overall, tactical curve positioning during the month also added 2 bps in relative performance which was offset by other tracking sources such as month-end effect and issue specific factors.

At month end our overall allocation, as measured by contribution to total duration, continued to favour provincial, agency and corporate sectors based on attractive valuations and stable fundamentals.

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CanPE-0318

SSgA Canadian Short Term Investment Fund Commentary

July 2012

The Canadian Short Term Investment Fund returned 0.11% for July 2012, outperforming the DEX 91 Day T-bill Index™ by 5 bps. The fund's performance for the month is explained by the positive yield carry of the fund over the index which has more than offset transaction costs. As of July 31st 2012, the Fund had an average term to maturity of 36 days for an annualized yield of 1.31%, compared to 91 days and 0.96% for the Index.

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US Markets Investment Commentary

July 2012

Overview and Outlook

After a tricky first half, during which an inspirational start to 2012 gave way to renewed reservations about global growth before equities mustered a hopeful close on the last day of June, the third quarter began with the benign sense that official intervention would once again protect financial markets from undue vulnerability. Sure enough on July 5, the Bank of England expanded its asset purchase program and the European Central Bank pared short-term interest rates by 25 basis points. But these moves could not forestall investor disappointment with another set of sluggish employment figures in the US, particularly after Premier Wen Jiabao of China offered downbeat economic comments that were echoed several days later by Oracle Warren Buffett of Omaha. Sentiment tried to stabilize in mid-July amid decent US bank earnings and building hopes that Federal Reserve Chairman Ben Bernanke might also unveil fresh easing policies, but Spanish bond yields broke out to new 2012 highs when claims by regional administrations on the central government further unsettled already precarious funding conditions. The deepening turmoil caught the attention of the ECB, whose leader Mario Draghi articulated a stern commitment to preservation of the euro. His language convinced investors that the ECB would soon deliver aggressive new measures to support sovereign debt markets, and global equity averages surged to finish a nerve-wracking July with modest gains. The prospect of more money supply made bond markets hesitate, but the steady diet of flaccid growth news still left them with solid returns for the month. Commodities also did well, bolstered in particular by soaring grain prices. Amid ongoing global angst over growth risks and financial weakness, July managed to kick off the second half with positive returns across all major asset classes.

Equities around the world used the late July rally to produce a second consecutive month of solid returns, but the felicitous final results belied considerable stresses and strains along the way. Most averages spent much of the month lower than where they had ended the first half, perturbed by the uncertain economic outlook and the inscrutable policy machinations in the eurozone. Further befuddling investors were inconsistent trends in second-quarter earnings releases. Although many companies had dialed expectations down in advance of their formal reports, and a clear majority of firms were therefore able to produce upside profit surprises, the revenue picture was less inspiring. Expectations for the remainder of the year were also variable, with many businesses dealing with currency volatility and competitive pressures. While President Mario Draghi of the ECB did come to the rescue of most equity benchmarks by pledging to defend the euro, returns within the equity markets were anything but uniform, with fundamental factors in specific companies producing an abundance of double-digit winners and losers in July alone. The net of all the noise, however, was an impressive number of countries and sectors that achieved modest gains for the month. The MSCI World Index of developed equity markets added 1.3% in July, lifting its year-to-date return to a respectable 7.3%. Returns across the emerging markets were slightly better in the latest month, with the range of country results even lower than in the developed markets. The MSCI Emerging Markets (EM) Free Index gained 2.0% in July, lifting its year-to-date result to 6.0% and thus making progress on reducing its 2012 underperformance relative to the developed markets.

Debt prices of troubled borrowers in southern Europe ebbed and flowed with broader global confidence during July, but major government bonds as well as corporate issues enjoyed steady yield declines throughout the month. Spurring the gains in fixed income was increasing recognition that the global economy, even though it was continuing to expand, could not generate enough momentum to alter the decidedly accommodative stance of major central banks any time soon. China trimmed interest rates in early July, almost simultaneously with the easing moves from the Bank of England and the European Central Bank, and notwithstanding notable rallies in energy and grain prices, several other emerging markets delivered rate cuts of their own as the month progressed. As if to corroborate these decisions, the International Monetary Fund lowered its global growth forecast for 2013 from 4.1% to 3.9%, having just raised it in April. Bond prices accordingly notched steady gains as July progressed, largely ignoring the ups and downs in the equity markets. Their only hiccup came late in the month after Mario Draghi suggested that the ECB was on the verge of using bolder policy tools to ameliorate funding conditions in the eurozone. For July as a whole, major government bonds posted healthy gains, with intermediate and longer issues faring especially well. Corporate debt did even better, as fluctuations in the equity market kept within a tolerable range and volatility could not get much traction. Even currency movements stayed relatively benign, allowing hedged and unhedged investors alike to enjoy solid fixed income returns in July.

While investors had to navigate subtle and swirling crosscurrents at the beginning of the second half, those who kept their portfolios on an even keel were rewarded with solid returns across a wide range of asset classes. The persistent penalty for seeking the safety of short-term securities, reflected most obviously in the measurably negative two-year yields in several European countries, appears likely to foster ongoing desire for riskier stocks, bonds, and alternatives that can provide greater income and higher potential return. Unfortunately, the challenging macroeconomic environment, the fragile financial landscape, and the competitive business backdrop make realization of these investment opportunities a task fraught with complexity. In the US and Japan, looming fiscal retrenchment threatens to weaken already tepid growth prospects. In Europe, overextended banks and sovereigns need fresh sources of capital to prevent disadvantageous liquidation of assets. And worldwide, corporations and consumers alike are watching with trepidation as governments struggle to deal with unaccustomed limitations to their economic hegemony. The solace for investors in the near term is that these challenges are much more widely appreciated than they were a year ago, when collapsing growth outlooks spawned a dauntingly difficult summer. In the second half of 2012, investors are confronting additional concerns amid rising grain prices and deceleration in China, but a more dangerous backdrop for equity markets may not develop until sentiment turns much less defensive and share prices have risen even further.

US Equities

After their ebullient surge at the end of June, stocks in the US had plenty of work to do to maintain their progress at the start of the second half. On the negative side, they were hit by nagging indications of a deteriorating growth outlook at home and a heightened sense of financial dislocation in Europe. More helpfully, economic malaise spurred hopes that the Federal Reserve would unleash fresh easing measures, and eurozone leaders vowed aggressive tactics to protect their currency. Amid the macro give and take, second-quarter earnings looked broadly respectable, though not without elements of concern for potential headwinds in the remainder of 2012. As July progressed, however, the highs and lows in the S&P 500® worked their way to progressively loftier levels, and thanks to the commitment to the euro expressed by Mario Draghi, the popular large-cap benchmark was able to finish the month on the heels of another late flourish. Smaller stocks had a somewhat rougher time, with rallies during July notching progressively lower highs; their struggles reflected a month where finding winners was less than straightforward. Among stocks in the S&P 500, there were more losers than gainers in July, and indeed with the exception of the May massacre, the proportion of advancing stocks was the lowest that it has been in 2012. The S&P 500 still managed to add 1.4% for the month, extending its year-to-date gain to 11.0%.

Larger stocks showed signs of lagging secondary issues during the equity rebound in June, and small cap and midcap averages continued their relative recovery in early July, rising nicely into the European policy easings on July 5. But then disappointing June employment figures arrived, and the budding improvement in smaller issues reversed almost instantly. As weak growth prospects became a prominent theme for the rest of the month, investors demonstrated an increasing preference for shares of the largest companies in recession-resistant businesses. The Russell 2000® Index of smaller stocks, having shown a nice pickup in June, lost 1.4% in July, giving back all its recent outperformance and then some. Since the start of 2012, the Russell 2000 has now gained 7.0%, 400 basis points less than the S&P 500. In similar but less drastic fashion, the S&P Midcap 400 IndexTM ended July within a rounding error of flat, leaving it with a year-to-date gain of 7.9% through the first seven months of 2012.

Relative performance between growth-oriented and value-oriented portfolios continued to be a choppy affair in July. Growth themes generally lagged in rally phases, since downtrodden value situations tended to react most positively to the prospect of central bank intervention and financial relief. But there remained much more variety within the style categories than between them. On the large cap side, the Russell 1000® Value Index added 1.0% in July, lifting its year-to-date result to 9.8%. This kept it slightly behind the Russell 1000® Growth Index, which climbed 1.3% on the month and has now gained 11.6% since the start of 2012. Value themes remained a modestly better proposition on the small cap side, as the Russell 2000® Value Index slipped just 1.0% in July, while the Russell 2000® Growth Index gave back 1.7%. That loss left the latter benchmark with a 6.9% gain on a year-to-date basis, dropping it slightly behind the 7.1% advance enjoyed by Russell 2000 Value over the same period.

Sector performance across the S&P 500 during July reflected an underlying preference for issues that pay ample dividends and tend to fluctuate less with the economy, but earnings results at individual companies often trumped the influence of broader themes. Eight out of the ten S&P sectors produced positive returns for the month, and all ten sectors are now in the black on a year-to-date basis. The weakest group in July was materials, which sank more than a percent as declining metal and coal prices weighed on the shares of producers. The consumer discretionary sector also slipped, hurt by fresh declines in education providers, as well as by retreats after poor earnings from some former darlings, like video purveyor Netflix and burrito marketer Chipotle Mexican Grill. On the positive side, the utilities and consumer staples sectors each outperformed the S&P by more than 100 basis points, fulfilling their role as defensive plays with solid dividends. But the top two sectors in July were telecommunications services and energy. Boosted by solid earnings reports, the telecom group scored a 6.5% advance for the month, lifting its impressive year-to-date gain of 24% even farther ahead of all other S&P sectors. As for the energy names, rebounding oil and gasoline prices allowed them to gain 4.2% in July and climb 1.7% into positive territory on a year-to-date basis. Alas, the springtime weakness in crude oil has still burdened the energy group with the weakest performance among S&P sectors on a year-to-date basis.

Global Fixed Income

With major central banks in accommodation mode and global growth prospects staying uncertain, most bond yields around the world continued to erode during July. Funding worries made Spain and Italy the obvious exception to the ongoing yield slippage, but even the bonds of these troubled borrowers ended the month showing considerable improvement from their worst levels. On July 5, nearly coincident easing moves by the UK, China, and the European Central Bank set the tone for the month. Other countries that pared rates as the month progressed included South Korea, the Philippines, South Africa, Brazil, and Colombia. Bond prices were able to resist pressure from the upward progress in equities, partly because share price appreciation was treacherous and halting, but also because the leadership on the equity side focused largely on more defensive issues. Further contributing to the support for intermediate and longer-term safe havens were the fresh jitters regarding Spanish finances. The Spanish two-year note briefly traded at a yield of 4% in early July, but as regional governments suggested that they would need sovereign assistance even as banking recapitalizations were already a looming concern, two-year yields ascended past 6.5% just three weeks later. As these levels constituted a dangerous threat to refunding auctions, ECB President Mario Draghi offered his bold commitment to euro preservation with the suggestion that normalization of funding conditions could be deemed part of the ECB mandate. Impressively, while two-year yields in Spain and Italy still ended July well above where they had begun, maturities inside of one year enjoyed notable declines over the course of the month. Longer-term yields stayed elevated, suggesting that investors remain quite nervous about growth and currency risks in the eurozone periphery, but the strong statements of Mr. Draghi averted any immediate disruption of funding conditions.

While Spain and Italy saw steeper curves in July, other term structures tended to flatten. Despite the clear commitment of major central banks to maintaining low interest rates, the simple fact is that short-term yields in most countries have little room to fall. In Europe, the largest yield declines were at intermediate maturities, while in the US, Canada, and Japan, it was the longest issues that performed best. The Australian yield curve actually inverted a bit during the month, as holders of shorter maturities became impatient waiting for the next ease from the Reserve Bank and found it burdensome to carry shorter paper at yields well below the cash target rate of 3.5%. Unhedged owners of Australian bonds nonetheless found plenty of comfort in another solid gain for the Aussie dollar. While other currencies around the world did not do quite as well against the US dollar in July, many still showed appreciation for the month, and the euro was the only major loser of note. Overall, unhedged dollar-based investors in the Citigroup World Government Bond Index (WGBI) benefited from a happy combination of local price appreciation and foreign exchange gains in several countries. The Barclays Capital US Treasury Index did its part by climbing 1.0% in July, and the WGBI was basically able to match that result on the month. On a year-to-date basis, though, the US dollar is still clinging to solid gains, and the WGBI has added just 1.4% since the start of the year. The US Treasury Index, helped in particular by its longer maturity issues, has gained 2.5% over the first seven months of 2012.

July was broadly favorable for the debt securities of major governments, but it was downright bountiful for issues trading at a spread premium over sovereign term structures. Improving equity markets, ebbing volatility, and persistent hunger for adequate income prompted steady tightening of mortgage and corporate issues, producing corresponding outperformance. The Barclays Capital US MBS Index added 0.8% for the month, extending its year-to-date return to 2.5% and staying right in line with the US Treasury Index, even though the latter has a considerably longer duration. The Barclays Capital US Corporate Index surged 2.9% in July, lifting its year-to-date advance to an impressive 7.7%. The one drawback of the continued strong performance is that the all-in yield of the US Corporate Index tumbled to a record low at the end of July, sinking to previously unimaginable depths beneath the 3% threshold. Such friendly financial conditions no doubt represent an ongoing boon to corporate borrowers, but they also leave long-term investors to struggle with onerous yield compression. For the moment though, with its smaller exposures to commercial mortgages and asset-backed paper also contributing nicely, the Barclays Capital US Aggregate Index added a solid 1.4% in July and has now appreciated by 3.8% since the beginning of 2012.

Bonds with ratings below investment grade also benefited from the benign July backdrop of easing volatility and constructive equity markets. But the structure of the high-yield market began to act as a limit on the upside of these securities. Many high-yield issues trade above par and have call features that may allow refinancing at the option of the borrower. One symptom of this effect is that the modified duration of the Barclays Capital US High Yield Index declined to less than four years at the end of July; the effective life of the bonds shortens as the call options come into play. Even though the average spread on the US High Yield Index saw a July decline that matched the tightening in investment-grade issues, the High Yield Index posted a smaller monthly gain of 1.9%. On a year-to-date basis, though, the generous coupons of the High Yield Index have helped preserve a generous seven-month return of 9.3%, a result that has been hard to compete with elsewhere in fixed income.

Alternative Assets

Real estate investment trusts (REITs) turned in another strong performance in July, as investors continued to find appeal in their stable income characteristics, and declining bond yields and credit spreads reinforced that attraction. The Dow Jones US Select REIT Index^{SM} outpaced the S&P 500 for a fifth consecutive month, climbing 1.9% in July and extending its impressive year-to-date advance to 17.1%. In keeping with the preference for more defensive sectors amid questions regarding growth prospects, healthcare REITs were the top sector among US REITs for the month, although malls and shopping centers remain in the lead on a year-to-date basis. Also strong in July were apartment and public storage names. Industrial and hotel names actually lost ground for the month, with the latter group now the weakest REIT performer since the start of the year. Outside the US, property names enjoyed continued 2012 resilience, handily outpacing both US REITs and broader averages of non-US equities.

Commodity benchmarks in July had their best month since October 2011, when they rebounded sharply with the equity markets. The key drivers in July 2012 were energy and grain prices. Brutally hot weather across a wide swath of the US spurred corn, wheat, and soybean prices to double-digit monthly gains. Natural gas climbed briskly as well, as the sweltering heat also lifted power consumption. Crude oil for its part benefited from diminished Iranian exports and ongoing Syrian civil war, with rising fears that Middle East tensions would erupt into more widespread military action. Industrial metals were conspicuously weak in July, with little clarity on Chinese demand and shaky economic data around the world. But precious metals were only slightly better, reflecting considerable skepticism that major central banks, regardless of their rhapsodic rhetoric, were ready to expand quantitative easing measures in significant new ways. Nonetheless, the metals malaise could not prevent the S&P GSCI® Commodity Index from surging 6.4% in July, a result that trimmed its year-to-date decline all the way back to 1.3%. As for the Dow Jones-UBS Commodity Index^{SM}, it climbed 6.5% for the month, lifting its year-to-date return back into positive territory by 2.5%.

Inflation-protected bonds reacted only slowly to the resurgent commodity prices of July, but since nominal yields were declining, real yields were able to resist any meaningful upward pressure. Indeed, real yields remained negative at all but the longest maturities in the UK, and in the US they were only slightly higher. Investors looking for a positive real yield in the US now have to venture beyond a 20-year maturity. Real yields in France dropped quite sharply in July, falling closer to their counterparts in the US and the UK. Correspondingly, low inflation expectations in France climbed notably through the month, while elevated inflation expectations in the UK continued to erode from higher levels. Inflation breakevens in the US split the difference, doing little through most of July before rallying late as commodity prices stayed firm. Helped also by their ample duration, US Treasury inflation-protected securities (TIPS) outperformed fixed-coupon issues in July, and the Barclays Capital US TIPS Index tacked on 1.9% for the month. The latest gain lifted the TIPS Index to a year-to-date return of 6.0%, which compares favorably with performance of all but the longest Treasury issues thus far in 2012, and in a curious convergence, matches almost exactly the seven-month return of the MSCI Emerging Markets Index. With real yields biased lower around the world, linkers outside the US showed similarly strong gains during July. Foreign exchange effects did not cost unhedged investors in non-US issues, as weakness in the euro was more than offset by resilience in other currencies.

Sources: Bloomberg, FactSet, Morgan Stanley, JPMorgan, RBS, Credit Suisse, Citigroup, SSgA Performance Group, MSCI

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